Congressional Research Service
Informing the legislative debate since 1914

IN FOCUS

Updated March 1, 2021

Section 301 Investigations: Foreign Digital Services Taxes (DSTs)

Background

An international debate is occurring over the global taxing rights of revenues and profits earned by multinational corporations (MNCs) in certain "digital economy" sectors. This debate is driven by concerns that these MNCs are not adequately taxed, and some governments argue that the right to tax some of the MNC profits should be reallocated from the jurisdiction where the MNC claims residence to the jurisdiction where the MNC's customers are located.

Some countries have imposed unilateral digital services taxes (DSTs) on the gross revenues earned by digital economy MNCs. These taxes target certain MNC digital transactions with domestic businesses or online activities directed ultimately toward domestic users, even if the corporation does not have a physical presence in the country. Some Members of Congress and others contend that, based on their design, many of these DSTs disproportionately target large U.S. MNCs. In addition, some observers argue that the proliferation of such unilateral measures could undermine basic principles of the current international taxation system.

The United States and more than 130 countries, comprising both members and nonmembers of the Organisation for Economic Cooperation and Development (OECD), are negotiating policy recommendations in an attempt to update the global tax system and develop an international digital tax framework. The OECD Secretariat originally announced its intent to conclude these negotiations by the end of 2020. However, due to the Coronavirus Disease 2019 (COVID-19) pandemic and critical policy differences among countries, the organization is now aiming to reach a deal by mid-2021.

Despite ongoing negotiations at the OECD, some countries, particularly in Europe and Asia, have proposed, announced, or implemented DSTs. France's DST—by far the most controversial—was the subject of a 2019 investigation by the U.S. Trade Representative (USTR), under Section 301 of the Trade Act of 1974. In June 2020, the USTR launched new investigations into the implemented or proposed DSTs of 10 other U.S. trading partners.

Overview of Section 301

Title III of the Trade Act of 1974 (Sections 301-310, codified at 19 U.S.C. §§2411-2420), titled "Relief from Unfair Trade Practices," is often collectively referred to as "Section 301." It grants the USTR a range of responsibilities and authorities to impose trade sanctions on foreign countries that violate U.S. trade agreements or engage in acts that are "unjustifiable," "unreasonable," or "discriminatory" and burden U.S. commerce. Prior to 1995, the United States used Section 301 to unilaterally pressure other countries to eliminate trade barriers and open their markets to U.S. exports. The creation of an enforceable dispute settlement mechanism in the World Trade Organization (WTO) in 1995, strongly supported at the time by the United States, significantly reduced the use of Section 301. While the United States retains the flexibility to seek recourse for foreign unfair trade practices in the WTO or under Section 301, a determination to bypass WTO dispute settlement and impose retaliatory measures (if any) in response to a Section 301 investigation may be challenged at the WTO.

France's Digital Services Tax

France enacted a DST formally on July 24, 2019. The DST applies a 3% levy on gross revenues derived from two digital activities of which French "users" are deemed to play a major role in value creation: (1) intermediary services, and (2) advertising services based on users' data. The law excludes certain services, including digital interfaces for the delivery of "digital content." The DST applies only to companies with annual revenues from the covered services of at least €750 million ($909 million) globally and €25 million ($30 million) in France. Covered companies are required to calculate revenues attributable to France (and, therefore, covered by the DST) using formulas specified in the law.

Section 301 Investigation of French DST

In its investigation, initiated in July and completed in December 2019, the USTR concluded that France's DST discriminates against major U.S. digital companies and is inconsistent with prevailing international tax policy principles. The findings of the investigation and the prospect of U.S. retaliation reportedly prompted France in January 2020 to suspend its DST for the remainder of 2020 and continue working with the United States at the OECD to reach a compromise on international digital taxation.

The USTR faced a July 10, 2020 statutory deadline to make a determination on what action—if any—to take as part of the Section 301 investigation; it ultimately determined that the United States should take retaliatory action in the form of additional duties. In July 2020, the agency announced that it would impose additional tariffs of 25% on about $1.3 billion worth of imports, or about 2.2% of all U.S. goods imports from France in 2019 (see **Text Box**). At the same time, the USTR also announced that it would delay the implementation for 180 days (until January 6, 2021) to allow more time for bilateral and multilateral discussions that could lead to a satisfactory resolution of this matter.

Proposed Section 301 Tariffs

The list of imports on which the USTR determined to impose tariffs is narrower than that originally proposed in December 2019, which had an annual import value of approximately $2.4 billion, covered dairy products, soaps, cosmetics, sparkling wine, handbags, and porcelain, and contemplated possible fees or restrictions on services of France. The final list is limited to certain cosmetics, soaps, and leather goods. According to the USTR, in determining the level of trade affected by the action, the agency considered the value of digital transactions covered by France's DST and the amount of taxes that France assesses on U.S. companies.

Because progress at the OECD has been relatively slow, and the deadline to reach an agreement had been pushed back to mid-2021, France announced in October 2020 that it would begin collecting its DST in December 2020. In response, the USTR did not modify or shorten the suspension announced in July 2020. More recently, in January 2021, the agency suspended indefinitely the additional Section 301 tariffs that were scheduled to go into effect that month in order to promote a coordinated response in all of the other DST investigations (see below).

Additional DST Investigations

In June 2020, the USTR launched new Section 301 investigations into the DSTs adopted or under consideration by Austria, Brazil, the Czech Republic, the European Union (EU), India, Indonesia, Italy, Spain, Turkey, and the United Kingdom (UK) (see **Text Box**). The USTR also requested consultations with the governments of these jurisdictions.

Recent Findings

In January 2021, the USTR issued findings in its investigations of DSTs adopted by Austria, India, Italy, Spain, Turkey, and the UK. It concluded that each of the DSTs—by their structure and operation—(1) discriminates against U.S. digital companies, (2) is inconsistent with the principles of international taxation (including, in some cases, due to their application to revenue rather than income, extraterritorial application, and failure to provide tax certainty), and (3) burden or restricts U.S. commerce. The USTR indicated at the time that it was not taking any specific actions in connection with the findings, but that it would continue to evaluate all available options and address the matter in subsequent Section 301 proceedings.

Ongoing Investigations

The Section 301 investigations of DST-related issues in Brazil, the Czech Republic, the EU, and Indonesia, are ongoing. As part of the investigations, the agency is seeking to address several issues, including:

- Are the taxes discriminatory and do they burden or restrict U.S. commerce? Are these jurisdictions unfairly targeting the taxes at certain U.S. firms?
- Is the tax policy "unreasonable"? The USTR has indicated that these DSTs appear to diverge from norms reflected in U.S. and international tax systems, particularly because of their extraterritorial scope and their taxing of revenue instead of income.
- Are the DSTs inconsistent with international commitments under the WTO or other agreements?

Outlook

If an agreement is not reached at the OECD in the near term, and the USTR determines that action in connection with the findings of the investigations is appropriate, the USTR could seek to negotiate and enter into a binding agreement that commits these trading partners to eliminate the tax policy or that provides compensation to the United States. The agency could also invoke the dispute settlement procedures of the WTO if the USTR determined that WTO agreements covered digital trade. Absent mutual resolution, it is unclear if the Biden Administration would impose tariffs or other trade restrictions. Should the United States impose such measures, affected parties could pursue WTO dispute settlement or retaliate by targeting U.S. exports.

DSTs Under Investigation

Adopted

Austria. Adopted a 5% tax on revenues from online advertising services. It applies to companies with at least €750 million ($909 million) in annual global revenues for all services and €25 million ($30 million) in in-country revenues for covered services.

India. Adopted a 2% tax that only applies to nonresident companies, and covers online sales of goods and services to, or aimed at, persons in India. The tax applies to companies with annual revenues in excess of approximately INR 20 million ($274,000).

Indonesia. Adopted a 10% value-added tax on digital products and services provided by nonresident companies with a "significant economic presence" in the Indonesian market, including music and video streaming services and applications.

Italy. Adopted a 3% tax on revenues from targeted advertising and digital interface services. The tax applies to companies generating at least €750 million ($909 million) in global revenues for all services and €5.5 million ($6.7 million) in in-country revenues for covered services.

Spain. Adopted a 3% tax on revenues from targeted advertising and digital interface services that would apply to companies generating at least €750 million ($909 million) in global revenues for all services and €3 million ($3.6 million) in in-country revenues for covered services.

Turkey. Adopted a 7.5% tax on revenues from targeted advertising, social media, and digital interface services. The tax applies to companies generating €750 million ($909 million) in global revenues from covered digital services and TRY 20 million ($2.9 million) in in-country revenues from covered digital services. The Turkish President has unilateral authority to increase the tax rate up to 15%.

United Kingdom. Adopted a 2% tax that applies to companies with "digital services revenues" exceeding £500 million ($696 million) and "UK digital services revenues" exceeding £25 million ($35 million).

Under Consideration

Brazil. Considering a 1% to 5% tax (to be levied progressively) on revenues from targeted advertising and digital interface services. It would apply to companies generating more than BRL 3 billion ($560 million) in annual global gross revenues and more than BRL 100 million ($19 million) in in-country revenues for covered digital services.

Czech Republic. Considering a 7% tax on revenues from targeted advertising and digital interface services. It would apply to companies generating €750 million ($847 million) in annual global revenues for all services and CZK 100 million ($4.7 million) in in-country revenues for covered services.

European Union. Discussing a potential DST based on a 2018 proposal that: (1) included a 3% tax on revenues from targeted advertising and digital interface services, and (2) would have applied only to companies generating at least €750 million ($909 million) in global revenues from covered digital services and at least €50 million ($61 million) in EU-wide revenues for covered services. (The 2018 proposal, which is the subject of the Section 301 investigation, may form the basis for renewed efforts to enact an EU-wide DST in the absence of an OECD agreement).

Source: CRS with information from Office of the USTR and news reports.
Note: U.S. dollar amounts are approximate due to exchange rate fluctuations.

Andres B. Schwarzenberg, Analyst in International Trade and Finance

IF11564

Disclaimer